No. 95-16

(3)

Supreme Court, U.S.
FILED
SEP 8 1995
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In The

Supreme Court of the United States

October Term, 1995

MARTIN L. MANDEL,

Petitioner,

vs.

FEDERAL DEPOSIT INSURANCE CORPORATION IN ITS CAPACITY AS MANAGER OF THE FSLIC RESOLUTION FUND, STATUTORY SUCCESSOR TO FSLIC IN ITS CORPORATE CAPACITY,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit

REPLY BRIEF FOR PETITIONER

NEIL A. KAPLAN
Counsel of Record
CLYDE, SNOW & SWENSON
201 South Main, Suite 1000
Salt Lake City, Utah 84111-2208
(801) 322-2516

VICTOR SIMON
10409 Mannakee Streeet
Kensington, MD 20895-2927
(301) 942-4005

Attorneys for Petitioner

7018
Lutz Appellate Services, Inc.
(800) 3 APPEAL • (800) 5 APPEAL • (800) BRIEF 21

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FURTHER REASONS FOR GRANTING THE WRIT

I.

THE DISTRICT COURT CONSIDERED THE ISSUE OF THE BURDEN OF PROOF WHICH PETITIONER RAISED AT THE EARLIEST POSSIBLE MOMENT.

Respondent suggests that Petitioner had ample opportunity to raise the burden of proof issue in the District Court but failed to do so. Respondent further suggests that Petitioner does not contend that he was surprised by unforeseen developments in the law. These contentions are simply incorrect. As pointed out in the Petition, the issue was squarely raised and, in fact, the District Court, in Conclusion of Law 18, specifically noted that "[t]he Court rejects defendant Mandel's contention that the fraud proven must be proved by clear and convincing evidence. It is sufficient if it is proved by a preponderance of the evidence and such burden of proof has been met by [the FDIC] in this case." (*See* Pet. at 8.)

While Petitioner did contend that the Utah standard of clear and convincing should apply, in reality the burden of proof was not an issue in the District Court. Specifically, the FDIC never contended in the District Court that the applicable standard should be anything other than the Utah standard of clear and convincing evidence. By contrast, the District Court for the first time in its Findings of Fact and Conclusions of Law announced a departure from the well-settled rule regarding the burden of proof for state common law fraud claims and applied a federal common law standard. The District Court's error was promptly raised as an issue on appeal. During the pendency of the appeal, Petitioner also brought to the attention of the Court of Appeals this Court's decision in *O'Melveny & Meyers v. FDIC*, 114 S. Ct. 2048 (1994) — a decision the Court of Appeals nevertheless chose to ignore.

The announcement by the District Court was clearly a surprise to Petitioner, representing an unforeseen development and a marked departure from the well-established Utah clear and convincing evidence standard to be applied to common law fraud claims. Accordingly, we urge the Court to grant the Petition for Certiorari on this issue, vacate the Judgment of the Court of Appeals and remand the case to that court for further consideration in light of this Court's decision in *O'Melveny & Meyers. See Patullo v. RTC,* 115 S. Ct. 44 (1994) (petition for certiorari granted; judgment vacated and case remanded to the court of appeals for further consideration in light of *O'Melveny*).

II.

THE APPLICATION OF THE WRONG BURDEN OF PROOF RESULTS IN A GROSS MISCARRIAGE OF JUSTICE.

Respondent asserts that the Court of Appeals' conclusion that Petitioner waived the burden of proof issue by failing to present it perfectly to the District Court presents no significant issue of law warranting this Court's review. As Respondent concedes, the Court of Appeals and this Court may consider issues whether properly preserved or not when the resolution is beyond any doubt or where injustice might otherwise result. One can only fantasize as to what case would fit within Respondent's concept of a miscarriage of justice if the application of the wrong burden of proof is not such a case. There is nothing more basic to our concepts of fundamental due process than the correct burden of proof. And, in this case, under *O'Melveny* it is beyond any doubt that the state law burden of proof should have been applied.

III.

A CONFLICT DOES EXIST AMONG THE CIRCUITS ON THE AVAILABILITY OF STATE LAW AFFIRMATIVE DEFENSES.

Respondent cites *FDIC v. Mijalis,* 15 F.3d 1314, 1323-24 (5th Cir. 1994) and *FDIC v. Bierman,* 2 F.3d 1424, 1438-41 (7th Cir. 1993), for the proposition that the Circuits are unanimous in holding that, under federal common law, in an action by the FDIC against a director of a failed institution, the director cannot raise the defense that the FDIC failed to mitigate damages.

The decision in *Mijalis, however, has recently been* under reconsideration by the Fifth Circuit. The Fifth Circuit, in light of this Court's decision in *O'Melveny,* granted a petition for interlocutory appeal on the question: "What affirmative defenses may be asserted by former directors and officers of a failed bank against the FDIC . . . in light of the Supreme Court's decision in *O'Melveny & Meyers v. FDIC*". *FDIC v. Schreinder,* No. 95-46 (5th Cir. April 13, 1995) (permitting appeal of *FDIC v. Schreinder,* 1995 WL 379963 (W.D. Tex. February 16, 1995)). Although *Schreinder* was settled in June 1995, the same issue was raised in a recent motion for certification of an interlocutory appeal filed by directors sued by the Resolution Trust Corporation ("RTC) in another Western District of Texas case, *RTC v. Hays,* No. SA-92-CA-0653 (W.D. Tex. Aug. 1, 1995) (defendants' request for certification of interlocutory appeal). Contrary to Respondent's assertion, the Fifth Circuit has not affirmed the District Court's opinion in *RTC v. Sands,* 863 F. Supp. 365 , 372 (N.D. Tex. 1964) relative to affirmative defenses. The cited opinion has not been appealed and, consequently, the Fifth Circuit has not yet addressed it.

Since this Court's decision in *O'Melveny,* the issue of a

defendant's ability to raise the defense of mitigation of damages against the FDIC has been addressed by three of the Circuits with a split among the Circuits as to the proper result. The majority reached the conclusion that when the FDIC, as receiver of a failed institution, brings an action under state law, applicable defenses are to be determined under state law. The Tenth Circuit, in the ruling below, is the only Circuit to deny the assertion of available state law defenses. Of note, is the fact that the Tenth Circuit did not mention *O'Melveny* in refusing to allow Petitioner to raise the affirmative defense of mitigation of damages against the FDIC. The Fifth Circuit in *Schreinder, supra,* has has agreed to examine the issue in light of *O'Melveny,* and in *FDIC v. Massingill,* 30 F.3d 601, 603-04 (5th Cir. 1994), that court held that the available defenses raised by a borrower were to be determined under applicable state law. It should be noted that in *Massingill,* the issue presented to the Fifth Circuit directly involved primary conduct of the FDIC. Likewise, the Third Circuit in *RTC v. Forest Grove, Inc.,* 33 F.3d 284, 288-91 (3rd Cir. 1994) found that available defenses were to be determined under state law.

IV.

CONTRARY TO RESPONDENT'S ASSERTION IN ITS BRIEF IN OPPOSITION, LAW DEVELOPED IN COMMERCIAL CASES IS EQUALLY APPLICABLE IN CASES AGAINST OFFICERS AND DIRECTORS.

Respondent contends in its Brief in Opposition that *Massingill, supra,* is inapposite to this case because it was not a suit against directors and because it applied mitigation principles from commercial law. This is a distinction without a difference. The distinction was not given even the barest mention by this Court in *O'Melveny,* a professional liability case, relying in part on *Coit Independence Joint Venture v. FSLIC,* 109 S. Ct. 13561 (1989), a commercial case.

Further, at least four courts of appeal have considered *O'Melveny* in a commercial context: *Massingill, supra*; *RTC v. Forest Grove, Inc., supra*; *RTC v. Maplewood Investments,* 31 F.3d 1276, 1290-91 (4th Cir. 1994) (expressing doubt as to the continued vitality of, and placing limits on, the federal common law holder in due course doctrine); and *Murphy v. FDIC,* No. 93-5268 (D.C. Cir. Aug. 1, 1995) (holding that *O'Melveny* displaced the federal common law doctrine established in *D'Oench Duhme & Co. v. FDIC,* 315 U.S. 447 (1942)).

CONCLUSION

The District Court in this case made the same error twice: inappropriately finding and applying federal common law which was markedly different from the applicable state law. On the burden of proof issue, as set forth in the Petition for a Writ of Certiorari, the Tenth Circuit refused to consider Petitioner's appeal based on a finding that Petitioner had failed to raise the issue below. As shown in the Petition, that finding is not only clearly erroneous, but flies in the face of the fundamental error doctrine of *Hormel v. Helvering,* 312 U.S. 552 (1941), and extensive jurisprudence in the lower courts on Fed. R. Civ. P. 60(b).

On the availability of state law affirmative defenses, *O'Melveny* requires the application of state law.

By granting certiorari in this case, this Court could correct the fundamental error of law and resolve the conflict between the Tenth Circuit and the Third and Fifth Circuits.

Respectfully submitted,

NEIL A. KAPLAN
Counsel of Record
CLYDE, SNOW & SWENSON
201 South Main, Suite 1000
Salt Lake City, Utah 84111-2208
(801) 322-2516

VICTOR SIMON
10409 Mannakee Street
Kensington, MD 20895-2927
(301) 942-4005

Attorneys for Petitioner